

Joan Marsh Director Federal Government Affairs Suite 1000 1120 20th Street NW Washington DC 20036 202 457 3120 FAX 202 457 3110

September 30, 2002

Via Electronic Filing
Ms. Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TWB-204
Washington, DC 20554

Re:

Notice of Oral Ex Parte Communication, <u>In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange</u> Carriers, CC Docket Nos. 01-338, 96-98 and 98-147

In the Matter of Federal-State Joint Board on Universal Service, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116

Dear Ms. Dortch:

On Friday, September 27, 2002, Len Cali, Joel Lubin, Bob Quinn and the undersigned, all representing AT&T, met with Commissioner Kevin Martin and Dan Gonzalez, his Legal Advisor. The purpose of the meeting was to respond to BOC presentations and assertions regarding the economics of UNE-P service offerings and the impact of UNE-P on BOC financials. All comments made at the meeting were consistent with the attached presentation materials.

At the meeting, we also made reference to a September 13 report on BellSouth by Lehman Brothers Equity Research, a copy of which is attached. On a field trip to BellSouth headquarters, Lehman Brothers found BellSouth senior management to be "upbeat," "optimistic" and "enthusiastic" about their growth businesses. Lehman Brothers reports:

On LD and UNEs: "BellSouth emphasized that their success in entering the LD market through 271 approval offers a considerable competitive advantage over the UNE players, and they expect that the appeal of Local/LD bundles will obviate the need for a major change in the UNE regulations."

On DSL: "Management is particularly enthusiastic about the progress of its DSL business, both from a growth and an economic standpoint. . . . The DSL business is projected to be EBITDA breakeven by YE02. The company believes the business will be solidly EBITDA positive in '03, bolstering overall margins."

On DSL v. cable broadband services: "In the second quarter, BellSouth's DSL business for the first time took a greater share of new broadband subscribers (51%) than the cable competition."

On capital spending: "Of the total 2002 capex budget, which represents about 17% of revenue expectations, management estimates that about 34% is for targeted new technologies. The roughly 1/3 of the capex budget is designed to boost the strategic capacity of the network to capture future growth opportunity."

These statements stand in contrast to a recent FCC presentation by BellSouth entitled "Wireline Telecommunications: Situation Analysis and Recommendations." In that presentation, BellSouth asserted that the telecom industry was in a crisis of "destructive competition" with huge, long-term negative implications for investment and innovation. BellSouth referred to the limited potential of long distances services and lagging BellSouth DSL market share (among other things), arguing that the "uneconomic rules related to network unbundling have destroyed value in the facility-based carriers and discouraged investment and innovation." These proclamations are a far reach from the messages delivered by BellSouth to Lehman Brothers, which views BellSouth as a "strong value" capable of generating \$5-6 B in free cash flow in 2002.

We also shared a Bear Stearns Equity Research report which summarizes a September 10, 2002 meeting between it and SBC management and which provides the basis for part of AT&T's UNE-P presentation. Again, SBC's assertions to Bear Stearns are in many ways contrary to the assertions being made by SBC to this Commission.

First, as to the long distance market, the report notes that "RBOC pricing is in-line or higher than the IXCs." This curious "meet-them or exceed-them" pricing strategy effectively rebuts the oft-repeated Bell company chorus that Bell entry into long distance markets generates significant consumer benefits.

Second, SBC "assumes that it can achieve 30% market share 12 months after entering a new [long distance] market and is targeting a long run (3-4 years) penetration rate in the 60% - 70% range." Given the conceded Bell company pricing strategy these are extraordinary projections. They certainly confirm that the Bells retain substantial power in the market for bundled local and long distance services, and that local markets are far from competitive.

Third, SBC's projected gains in the long distance market stand in contrast to its relatively modest losses in local markets. This disparity makes all the more unseemly SBC's campaign to gain government protection against UNE-based competition in local voice telephone markets.

SBC also asserts that it can partly stabilize its local market losses by offering bundled packages of local and long distance services. Thus, even SBC concedes that the answer to SBC's concerns with local market competition is for it to comply with its Section 271 obligations throughout its region -- not to seek government protection from local competition.

Finally, in the context of the Universal Service proceeding, we reiterated our support for a per connection, collect and remit mechanism to replace the existing percentage revenue assessment mecanism to be implemented April 1, 2002. We explained that while AT&T cannot implement the Phase I implementation stage as specifically described in the COSUS proposal on April 1, we are looking at alternatives that would enable AT&T to implement a solution that would comport with the spirit of that proposal.

Consistent with Commission rules, I am filing one electronic copy of this notice and request that you place it in the record of the above-referenced proceedings.

Sincerely,

Joan Marsh

cc: Daniel Gonzalez
Thomas Navin
Robert Tanner

Jeremy Miller

UNE-P vs. 271 LD Entry:

What's the real tradeoff for the RBOCs?

September 24, 2002

Key steps for telecom policy

- Create competitive local telecom markets through:
 - Wholesale markets for unbundled network elements (251)
 - Priced at competitive compensatory levels (252)
- Allow previous local monopolists into long distance markets (271)
- Phase out regulation of retail services
- Provides a win-win-win solutions for ILECs, CLECs and customers

Complexities of revenue estimation

Component	Definition	Our data source(s)	Common estimation errors
Basic local \$13.78	Rate paid for line rental and local usage typically combined as 1FR	CCMI rates mapped to WC and rolled up by UNE zone	Figures that include business revenue with residence or reflect only high-end local service bundles
Features \$6.86	Revenues from sale of vertical features (e.g., Caller ID, Call Waiting, etc.) either as explict separate charges or implicit within "Total Service" bundles	Study area estimate per HH from TNS Telecoms Bill Harvesting database	Figures that reflect only high use bundles or assume excessive "take" rates; inclusion of nonUNE-related features (ISW, VM)
Subsidies \$0.67	State and Federal USF subsidy payments as well as CALLS-related subsidy payments	Regulatory filing documents	Ignored, measured by collections rather than receipts, or entitlement not consistently associated with particular zone
SLC \$5.51	Interstate (and, occasionally intrastate) access end user charges typically to support loop costs	Analysis of TRP data	Intrastate may be neglected
Access \$1.99	Access revenue from unaffiliated IXCs or access savings (relative to UNE rates) enjoyed by affiliated IXCs	AT&T's estimate of access rates and TNS Telecoms Bill Harvesting derived toll minutes	Including business usage and/or dedicated transport
<i>Total</i> \$28.81	Sum of above components		Top-down figure that includes revenues not related to residential local service

Complexities of UNE-P cost estimation

Element	Definition	Common estimation errors	Examples of quirky practices
Loop \$13.29	Network Interface Device (NID), Distribution, FDI/DLC, Feeder	Use of UNE-L rate rather than UNE-P rate; use targeted zone rate or rates averaged across zones based on distribution of total lines rather than residence lines	Some Qwest states have multiple loop rates within a WC. Many BLS states have different rates for UNE-L loops vs. UNE-P loops.
Port/features \$2.06	Line connection to the switch and feature capability	Failure to include feature costs in port rate (flat or per-feature)	Texas applies 4 different port rates as a function of the number of lines in the local calling area served by the switch. CA charges \$0.19 extra per feature. Many BLS states have higher rates for ports with features (e.g., FL additive is \$2.26)
Switch Usage \$3.42 (figure includes transport and signaling charges)	Call attempt and holding time charges for the switch including trunk ports	Understated usage level and/or level not specific to the state	CA has 3 sets of set-up and duration charges for intraswitch, interswitch and terminating usage. Many VZ states apply 2 switching charges on intraswitch minutes.
Interoffice transport and signaling	Common transport, tandem switching and signaling	Ignored or understated	Signaling may be incorporated in switching rate
Daily Usage Feed/Files (DUF) \$0.50	Transmittal of information regarding usage data	Very difficult to measure, often ignored or understated	Based on number of usage records, rate and number of records may differ by call type
Miscellaneous \$0.06		White pages and OSS charges in some states — invariably overlooked	
Nonrecurring costs \$0.30	Charges for new customer migration or install	Ignored or selected rate element inconsistent with customer mix	Rate structures very complex and idiosyncratic
<i>Total UNE-P</i> \$19.63			

Wholesale costs and revenues

Wholesale Costs of UNE-P to CLECs	Loop	Port	Usage	DUF	Misc	Amort of NRC	Total UNE-P
All RBOCs	\$13.29	\$2.06	\$3.42	\$0.50	\$0.06	\$0.30	\$19.63
BellSouth	\$15.14	\$2.33	\$3.69	\$1.72	\$0.00	\$0.18	\$23.07
Qwest	\$16.30	\$1.43	\$5.08	\$0.13	\$0.18	\$0.75	\$23.87
SBC	\$11.33	\$2.09	\$2.18	\$0.23	\$0.00	\$0.24	\$16.07
Verizon	\$13.49	\$2.10	\$4.32	\$0.18	\$0.14	\$0.28	\$20.51

Revenues Gained from							Gross Ma	rgin
Sale of UNE-P by CLECs	Basic	Features	Subsidies	SLC	Access	Total	(\$)	(%)
All RBOCs	\$13.78	\$6.86	\$0.67	\$5.51	\$1.99	\$28.81	\$9.17	32%
BellSouth	\$13.29	\$8.90	\$0.88	\$6.00	\$1.20	\$30.26	\$7.19	24%
Qwest	\$14.41	\$7.00	\$0.45	\$5.75	\$2.13	\$29.74	\$5.86	20%
SBC	\$12.80	\$6.55	\$0.89	\$4.98	\$1.91	\$27.12	\$11.05	41%
Verizon	\$15.33	\$5.75	\$0.28	\$5.83	\$2.64	\$29.83	\$9.32	31%

All rates used in this presentation are current as of 8/9/02

All RBOC post-271 Res analysis

	-9-10-0-10-0-10-0-10-0-10-0-10-0-10-0-1	10 mm	Salara Maria Cara	Contracting and the second sec	
	Total RBOC	BellSouth	Qwest	SBC	Verizon
Total Residential lines	84,547,824	16,937,608	10,459,763	34,341,186	22,809,266
esidential UNE-P Economics					
Retail revenue	\$28.81	\$30.26	\$29.74	\$27.12	\$29.83
Avoided retail cost	\$4.21	\$4.37	\$3.37	\$4.04	\$4.74
Net retail revenue loss	\$24.60	\$25.90	\$26.37	\$23.09	\$25.09
Wholesale UNE-P revenue	\$19.63	\$23.07	\$23.87	\$16.07	\$20.51
Lost margin per UNE-P line	\$4.96	\$2.83	\$2.50	\$7.02	\$4.58
UNE-P Res lines @ 15%	12,682,174	2,540,641	1,568,964	5,151,178	3,421,390
Annual margin lost from UNE-P	\$755,059,777	\$86,169,746	\$47,032,846	\$433,865,468	\$187,991,717
esidential RBOC LD Economics					
Retail revenue @ \$0.12	\$11.63	\$11.97	\$10.49	\$11.69	\$11.80
Incremental cost @ \$0.05	\$4.84	\$4.99	\$4.37	\$4.87	\$4.92
Gained margin per Res LD line	\$6.78	\$6.98	\$6.12	\$6.82	\$6.88
LD Res lines @ 30%	25,364,347	5,081,283	3,137,929	10,302,356	6,842,780
Annual margin gained from LD	\$2,064,101,561	\$425,696,161	\$230,439,930	\$842,909,710	\$565,055,760
et UNE-P + LD Margin Change	\$1,309,041,784	\$339,526,416	\$183,407,083	\$409,044,242	\$377,064,043

All RBOC UNE-P vs. LD entry tradeoff

Data: All RBOCS Post-2

Post-271 Total

Total Residential lines

84,547,824

Lost margin per UNE-P line Gained margin per Res LD line

\$4.96 \$6.78

Change in Net Margin Earned by the RBOCs (\$ Millions)

Share of Residence Long Distance Gained by RBOC

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	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
10%	\$185	\$873	\$1,561	\$2,249	\$2,937	\$3,625	\$4,313	\$5,001	\$5,689	\$6,377
20%	(\$319)	\$369	\$1,057	\$1,745	\$2,433	\$3,121	\$3,809	\$4,498	\$5,186	\$5,874
30%	(\$822)	(\$134)	\$554	\$1,242	\$1,930	\$2,618	\$3,306	\$3,994	\$4,682	\$5,370
40%	(\$1,325)	(\$637)	\$51	\$739	\$1,427	\$2,115	\$2,803	\$3,491	\$4,179	\$4,867
50%	(\$1,829)	(\$1,141)	(\$453)	\$235	\$923	\$1,611	\$2,299	\$2,987	\$3,675	\$4,363
60%	(\$2,332)	(\$1,644)	(\$956)	(\$268)	\$420	\$1,108	\$1,796	\$2,484	\$3,172	\$3,860
70%	(\$2,836)	(\$2,148)	(\$1,460)	(\$771)	(\$83)	\$605	\$1,293	\$1,981	\$2,669	\$3,357
80%	(\$3,339)	(\$2,651)	(\$1,963)	(\$1,275)	(\$587)	\$101	\$789	\$1,477	\$2,165	\$2,853
90%	(\$3,842)	(\$3,154)	(\$2,466)	(\$1,778)	(\$1,090)	(\$402)	\$286	\$974	\$1,662	\$2,350
100%	(\$4,346)	(\$3,658)	(\$2,970)	(\$2,282)	(\$1,594)	(\$906)	(\$217)	\$471	\$1,159	\$1,847

SBC "aconomics"

- SBC states that:
 - Its res UNE-P line loss stabilizes at between 15 and 20%
 - It sells LD
 - At prices ≥ IXC rates (or at ~50% margins), and
 - targets attaining a 60 to 70% market share in 4-5 years
- These statements confirm the highly favorable nature of the UNE-P/LD tradeoff to SBC
- Thus in whole, the TelAct has been a boon to SBC, not a bust

Relative Margin Analysis	SBC
Total Residential lines	34,341,186
Residential UNE-P Economics	
Retail revenue Avoided retail cost Net retail revenue loss	\$27.12 \$4.04 \$23.09
Wholesale UNE-P revenue	\$16.07
Lost margin per UNE-P line	\$7.02
UNE-P Res lines @ 20%	6,868,237
Annual margin lost from UNE-P	\$578,487,291
Residential RBOC LD Economics	
Retail revenue @ \$0.12 Incremental cost @ \$0.06 Gained margin per Res LD line	\$11.69 \$5.84 \$5.84
LD Res lines @ 60%	20,604,712
Annual margin gained from LD	\$1,444,988,073
Net UNE-P + LD Margin Change	\$866,500,783

UNE-P wholesale cost

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			_				Amort	Total	
Holding Company	State	Loop	Port	Usage	DUF 04.70	Misc	of NRC	UNE-P	
Bellsouth	AL	\$15.31	\$2.24	\$2.66	\$1.76	\$0.00	\$0.14	\$22.11	
Southwestern Bell	AR	\$14.30	\$1.61	\$2.40	\$0.68	\$0.00	\$0.29	\$19.28	
Us West	AZ	\$12.92	\$1.61	\$9.83	\$0.00	\$0.00	\$1.14	\$25.49	
Pacific Telesis	CA	\$10.18	\$1.21	\$1.82	\$0.00	\$0.00	\$0.09	\$13.30	
Us West	CO	\$16.61	\$1.53	\$3.91	\$0.22	\$0.00	\$0.13	\$22.40	
Southern New England	CT	\$11.88	\$3.31	\$6.35	\$0.00	\$0.00	\$0.00	\$21.54	
Bell Atlantic	DC	\$10.81	\$1.55	\$3.73	\$0.05	\$0.00	\$0.37	\$16.52	
Bell Atlantic	DE	\$12.22	\$2.23	\$5.54	\$0.08	\$0.00	\$1.04	\$21.12	
Bellsouth	FL.	\$15.85	\$3.43	\$2.57	\$2.52	\$0.00	\$0.15	\$24.52	
Bellsouth	GA	\$12.76	\$1.79	\$5.78	\$2.05	\$0.00	\$0.11	\$22.48	
Us West	IA	\$16.79	\$1.15	\$4.85	\$0.25	\$1.38	\$0.18	\$24.59	
Us West	ID	\$20.90	\$1.34	\$3.93	\$0.21	\$0.00	\$0.18	\$26.56	
Ameritech	IL	\$9.80	\$2.11	\$0.61	\$0.08	\$0.00	\$0.08	\$12.69	
Ameritech	IN	\$8.33	\$3.13	\$0.95	\$0.00	\$0.00	\$0.01	\$12.42	
Southwestern Bell	KS	\$13.78	\$1.61	\$2.58	\$0.70	\$0.00	\$0.23	\$18.90	
Bellsouth	KY	\$12.53	\$1.15	\$4.32	\$0.99	\$0.00	\$0.20	\$19.19	
Bellsouth	LA	\$16.98	\$1.36	\$5.29	\$0.91	\$0.00	\$0.14	\$24.68	
Nynex Svc Co	MA	\$15.33	\$2.00	\$7.30	\$0.00	\$0.00	\$0.09	\$24.71	
Bell Atlantic	MD	\$14.94	\$1.90	\$6.49	\$0.09	\$0.00	\$0.19	\$23.62	
Nynex Svc Co	ME	\$16.44	\$0.94	\$3.86	\$0.85	\$0.00	\$0.00	\$22.08	
Ameritech	MI	\$10.09	\$2.53	\$1.10	\$0.12	\$0.00	\$0.05	\$13.90	
Us West	MN	\$18.55	\$1.08	\$4.19	\$0.00	\$0.00	\$0.07	\$23.89	
Southwestern Bell	МО	\$15.27	\$1.90	\$2.40	\$0.00	\$0.00	\$0.25	\$19.83	
Bellsouth	MS	\$18.30	\$2.55	\$2.95	\$1.61	\$0.00	\$0.27	\$25.69	
Us West	MT	\$23.72	\$1.58	\$6.88	\$0.26	\$0.00	\$0.17	\$32.61	
Bellsouth	NC	\$14.61	\$2.19	\$4.17	\$0.92	\$0.00	\$0.19	\$22.08	
Us West	ND	\$18.25	\$1.27	\$7.31	\$0.36	\$3.49	\$0.18	\$30.86	
Us West	NE	\$17.47	\$2.47	\$5.33	\$0.23	\$2.52	\$0.16	\$28.19	
Nynex Svc Co	NH	\$18.44	\$0.71	\$3.98	\$0.24	\$0.00	\$0.00	\$23.38	
Bell Atlantic	NJ	\$9.52	\$1.91	\$2.10	\$0.37	\$0.00	\$0.33	\$14.24	
Us West	NM	\$20.79	\$1.38	\$3.45	\$0.00	\$0.00	\$1.63	\$27.26	
Pacific Telesis	NV	\$21.22	\$1.63	\$7.07	\$0.00	\$0.00	\$0.36	\$30.28	
Nynex Svc Co	NY	\$12.12	\$2.57	\$2.39	\$0.22	\$0.54	\$0.28	\$18.12	
Ameritech	ОН	\$8.51	\$3.13	\$1.87	\$0.21	\$0.00	\$0.11	\$13.84	
Southwestern Bell	ok	\$15.87	\$2.28	\$4.10	\$0.72	\$0.00	\$0.26	\$23.24	
Us West	OR	\$15.43	\$1.14	\$2.92	\$0.00	\$0.00	\$3.26	\$22.75	
Bell Atlantic	PA	\$14.23	\$2.67	\$3.26	\$0.08	\$0.00	\$0.23	\$20.47	
Nynex Svc Co	RI	\$14.14	\$1.86	\$3.52	\$0.00	\$0.00	\$0.00	\$19.52	
Bellsouth	sc	\$16.72	\$2.80	\$3.34	\$1.76	\$0.00	\$0.28	\$24.89	
Us West	SD	\$21.26	\$1.84	\$4.57	\$0.00	\$0.00	\$7.15	\$34.82	
	}	\$14.41	A	A			\$0.27	\$20.26	
Bellsouth Southwestern Bell	TN TX	\$14.33	\$1.70 \$2.22	\$2.72 \$3.13	\$1.16 \$0.88	\$0.00 \$0.00	\$0.27 \$0.17	\$20.74	
Us West	UT	\$14.33 \$13.15	\$2.22 \$1.58	\$4.07	\$0.66 \$0.13	\$0.00 \$0.00	\$0.17 \$0.09	\$19.01	
Bell Atlantic				\$4.07 \$6.37		\$0.00 \$0.00	\$0.09 \$0.59	\$23.09	
	VA	\$14.74	\$1.30 \$0.06		\$0.08	\$0.00 \$0.00	\$0.09 \$0.00	\$23.09	
Nynex Svc Co	VT	\$13.81	\$0.96 \$1.24	\$8.31 \$3.61	\$0.86	•		\$23.94 \$19.93	
Us West	WA	\$14.56	\$1.34 \$2.74	\$3.61	\$0.31 \$0.40	\$0.00	\$0.11 \$3.57	\$19.93	
Ameritech	WI	\$10.90	\$3.71	\$2.62	\$0.19 \$0.40	\$0.00	\$3.57 \$0.66		
Bell Atlantic	WV	\$26.72	\$1.60	\$16.57	\$0.10	\$0.00	\$0.66	\$45.64	
Us West	WY	\$22.95	\$2.64	\$4.18	\$0.25	\$0.00	\$0.17	\$30.20	

UNE-P associated revenue

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		Basic &	Basic &					
Holding Company	State	Features	Subsidies	SLC	Access	Total	Gross M	(%)
Bellsouth	AL	\$25.32	\$1.72	\$6.00	\$0.85	\$33.89	\$11.78	359
Southwestern Bell	AR	\$22.94	\$0.63	\$5.27	\$2.46	\$31.30	\$12.02	389
Us West	AZ	\$21.06	\$0.91	\$6.00	\$1.74	\$29.71	\$4.22	149
Pacific Telesis	CA	\$15.82	\$2.71	\$4.48	\$2.16	\$25.17	\$11.88	479
Us West	co	\$22.74	\$0.49	\$6.00	\$2.13	\$31.36	\$8.95	29%
Southern New England		\$17.03	\$0.03	\$5.78	\$2.52	\$25.35	\$3.81	159
Bell Atlantic	DC	\$20.15	\$0.00	\$3.86	\$0.00	\$24.01	\$7.49	319
Bell Atlantic	DE	\$13.77	\$0.08	\$6.00	\$1.13	\$20.98	(\$0.13)	-19
Bellsouth	FL	\$18.68	\$0.39	\$6.00	\$2.00	\$27.07	\$2.56	99
Bellsouth	GA	\$26.27	\$0.35	\$6.00	\$0.79	\$33.41	\$10.93	339
Js West	IA	\$18.04	\$0.00	\$4.72	\$1.85	\$24.61	\$0.03	09
Js West	iD	\$20.42	\$0.00	\$6.00	\$2.56	\$28.98	\$2.42	89
Ameritech	il l	\$23.53	\$0.00	\$4.49	\$0.77	\$28.79	\$16.10	569
Ameritech	IN	\$19.31	\$0.00	\$5.52	\$0.77	\$25.74	\$13.31	529
Southwestern Bell	KS	\$20.87	\$0.06	\$5.27	\$3.08	\$29.27	\$10.37	359
Bellsouth		\$20.67	\$0.00 \$0.46	\$6.00	\$0.55	\$31.21	\$12.02	389
Bellsouth	KY	\$21.91	\$0.46 \$0.42	\$6.00	\$1.00	\$29.33	\$4.65	169
	LA			\$6.00 \$6.00		\$30.88	\$6.16	209
Nynex Svc Co	MA	\$23.77	\$0.00 \$0.46		\$1.10 \$4.06		\$6.10 \$7.98	25
Bell Atlantic	MD	\$23.80	\$0.16	\$5.68	\$1.96	\$31.60		20
Nynex Svc Co	ME	\$20.00	\$0.84	\$6.00	\$0.87	\$27.70	\$5.62	
Ameritech	MI	\$24.18	\$0.00	\$5.34	\$1.11 \$4.00	\$30.63	\$16.74	55
Js West	MN	\$21.82	\$0.00	\$4.89	\$1.36	\$28.07	\$4.18	15
Southwestern Bell	МО	\$18.27	\$0.13	\$5.27	\$2.51	\$26.17	\$6.34	249
Bellsouth	MS	\$27.59	\$8.21	\$6.00	\$0.53	\$42.34	\$16.65	399
Js West	MT	\$23.53	\$2.67	\$6.00	\$4.14	\$36.33	\$3.72	10
Bellsouth	NC	\$18.21	\$0.00	\$6.00	\$1.11	\$25.31	\$3.23	139
Js West	ND	\$25.68	\$0.39	\$6.00	\$2.57	\$34.64	\$3.77	119
Js West	NE	\$27.33	\$0.00	\$5.16	\$1.85	\$34.33	\$6.15	189
Nynex Svc Co	NH	\$19.64	\$0.15	\$6.00	\$2.27	\$28.06	\$4.68	179
Bell Atlantic	NJ	\$16.99	\$0.08	\$5.35	\$5.63	\$28.05	\$13.81	49
Js West	NM	\$19.83	\$0.38	\$6.00	\$5.16	\$31.37	\$4.12	139
Pacific Telesis	NV	\$14.94	\$0.83	\$5.37	\$2.09	\$23.23	(\$7.05)	-30
Nynex Svc Co	NY	\$23.47	\$0.17	\$6.00	\$1.95	\$31.58	\$13.47	439
Ameritech	ОН	\$20.78	\$0.00	\$5.38	\$1.06	\$27.22	\$13.38	499
Southwestern Bell	OK	\$20.66	\$0.32	\$5.27	\$1.36	\$27.62	\$4.38	169
Js West	OR	\$22.28	\$0.12	\$6.00	\$1.72	\$30.12	\$7.37	24
Bell Atlantic	PA	\$17.26	\$0.00	\$6.00	\$2.46	\$25.71	\$5.24	209
Nynex Svc Co	RI	\$18.03	\$0.01	\$6.00	\$1.14	\$25.19	\$5.67	229
Bellsouth	SC	\$23.33	\$0.54	\$6.00	\$1.77	\$31.64	\$6.74	219
Js West	SD	\$22.90	\$0.04	\$6.00	\$3.13	\$32.07	(\$2.75)	-99
Bellsouth	TN	\$22.11	\$0.20	\$6.00	\$0.70	\$29.00	\$8.75	309
Southwestern Bell	TX	\$19.96	\$0.00	\$5.27	\$3.17	\$28.40	\$7.66	279
Js West	UT	\$21.38	\$0.15	\$6.00	\$1.92	\$29.45	\$10.44	359
Bell Atlantic	VA	\$20.88	\$0.39	\$6.00	\$3.21	\$30.48	\$7.40	249
Nynex Svc Co	VT ·	\$21.12	\$3.29	\$6.00	\$2.73	\$33.15	\$9.20	289
Us West	WA	\$18.80	\$0.00	\$5.92	\$2.19	\$26.90	\$6.97	269
Ameritech	WI	\$20.85	\$0.00	\$5.06	\$0.76	\$26.67	\$5.68	219
Bell Atlantic	wv	\$35.51	\$4.81	\$6.00	\$2.56	\$48.88	\$3.24	79
Us West	WY	\$34.33	\$7.68	\$6.00	\$0.81	\$48.83	\$18.64	389

Conclusions

- RBOCs reveal that they gain more from LD than lose from UNE-P
 - In many states, RBOC pressure to receive 271 relief has spurred substantial UNE-P rate reductions – frequently as the result of unilateral RBOC price concessions
 - RBOC decisions to pursue 271 shows they believe LD entry to be richer than potential UNE-P losses
 - This is confirmed by our UNE-P/LD margin tradeoff analyses
- Viable UNE markets keep traffic on and investment in RBOC networks

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September 13, 2002

BellSouth Corp (BLS - \$23.20) 1-Overweight

Company Update

Field Trip Highlights

United States
Telecommunications
Telecom Services - Wireline

Blake Bath 1.202.452.4732 bbath@lehman.com

Investment conclusion

□ We hosted a field trip to BLS yesterday, where mgmt was upbeat about progress on several fronts, particularly within the Consumer and Business 4Majors. We are maintaining our positive long term outlook on the shares.

Summary

- BLS is optimistic about its 271-approval process, and expects to be marketing in its entire local region by YE02.
- ☐ BLS emphasized that their success in entering the LD market through 271 approval offers a considerable advantage over the UNE players.
- Mgmt very enthusiastic about DSL progress. In 2Q, BLS's DSL business for the first time took a greater share of new BB subs than the cable cos. The DSL business is projected to be EBITDA b/e by YEO2.
- ☐ BLS expressed no interest in an IXC acquisition.

 Mgmt noted that it views Consumers/SMEs as its prime mkts.
- □ View BLS as strong value. Co should generate \$5-\$6B in FCF in 02, and generates a 3.4% dividend yield for investors.

Stock Rating:	• •	•	Target

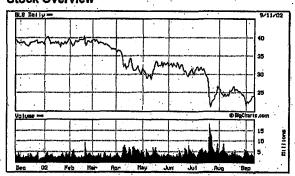
New: 1-Overweight New: 30.00
Old: 1-Overweight Old: 30.00

Sector View: 1-Positive

EPS	, ; (F)	(Dec)	•				•		• .
	2001		2002			2003		% Cł	ange
	Actual	Old.	Nevel	St. Est	Old -	News	St. Est	2002	2003
1Q	0.56	0.54A	(0)/a/4/A	0.54A	0.54E	0.646	0.60E	(4)	0.
2Q	0.59	0.53A	01.55XA	0.53A	0.55E	0.5654	0.53E	(10)	4
3Q	0.61	0.50E	0.60	0.50E	0.51E	- 0,50E)	0.51E	(18)	2
4Q .	0.65	0.53E	(0.50)	0.52E	0.56E	O clos	0.56E	(18)	6
Year	2.41	2.10E	72,00EM	2.08E	2.15E	. P2:16E%	2.14E	(13)	. 2
			Management B			100 DEC 100			

Market Data		Financial Summary	
Market Cap	43685.6M	Revenue FY02	28.70
Shares Outstanding (Mil)	1883.0	Five-Year EPS CAGR	7.30
Float	NA	Return on Equity	NA
Dividend Yield	NA.	Current BVPS	8.4
Convertible	No	Debt To Capital	34.9
52 wk Range	42.95 - 20.10		

Stock Overview



Summary and Investment Conclusion

We hosted a field trip to BellSouth yesterday, and the following highlights are based on presentations by senior management. Despite the difficult operating environment, management was upbeat about progress on several fronts, particularly within the Consumer and Business 4Majors. Though the telecom environment continues to prove extraordinarily challenging, we firmly believe that BellSouth's management team is navigating well and doing the right things to reward equity investors. The company should generate \$5-\$6B in Free Cash Flow in 2002, and recently increased the quarterly dividend by 5.3%. Moreover, the company has already deleveraged by \$2B this year, improving an already-pristine balance sheet and clearing the way to buy back stock without any ratings agency pressure. We reiterate our 1-Overweight on the shares.

Highlights from yesterday's meeting follow, organized according to our 4Major customer segments.

Consumer 4Major Highlights

271 Applications: The company is optimistic about its 271-approval process, and expects to be marketing in its entire local region by the end of the year. Management anticipates FCC approval to provide LD service in 5 states (NC, SC, KY, AL, MS) next week on 9/18, and will file its remaining 2 states (FL and TN) immediately thereafter. We estimate that the five-state application represents 35% of BLS access lines and a \$5.7B revenue opportunity. Florida and Tennessee

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represent an additional \$6.1B opportunity and 38% of lines. The company expects to be in all states by December 21, becoming the first Bell to be able to market LD in its entire local region. We view the schedule outlined today as largely in line, but nonetheless a positive given the potential revenue growth contribution, as well as the ability it affords the company to be more competitive against UNE-P based providers.

UNE-P: Regarding UNE competition, the company revealed that in their planning they do not anticipate a near-term resolution to the issue, which represents the company's largest near-term competitive threat. Management anticipates that the FCC's Triennial Review is unlikely to provide any substantial overhaul to the UNE system. However, BellSouth emphasized that their success in entering the LD market through 271 approval offers a considerable competitive advantage over the UNE providers, and they expect that the appeal of Local/LD bundles will obviate their need for a major change in UNE regulations. The company noted that MCI has made a big push in Florida with its "Neighborhood" program, but questions the viability of this effort given the company's financial position coupled with the large upfront investment needed to launch a local strategy.

Consumer Data: Management is particularly enthusiastic about the progress of its DSL business, both from a growth and an economic standpoint. In the second quarter, BellSouth's DSL business for the first time took a greater share of new broadband subscribers (51%) than the cable competition. This represents a sizeable improvement in flowshare versus the year ago period when the company took just 40% of new broadband subs. BellSouth expects to hold 44% of the broadband market by YE02, up 400bps yoy. We note that cable modem competitors had a 2-year head start on BLS in broadband sales.

From an economic standpoint, BLS reports that the DSL business is making excellent progress. The DSL business is projected to be EBITDA breakeven by YE02. Recurring costs have fallen 60% in the past two years, while non-recurring costs have declined 80%. The company believes the business will be solidly EBITDA positive in '03, bolstering overall margins.

Business and Enterprise 4Major Highlights

BellSouth expressed confidence in its positioning in the Business 4Major, and noted that with upcoming LD-entry it is poised to capture significant incremental share in the SME market, which has shown enthusiastic response to LD/local bundles. Importantly, management reported that it has seen a plateau and possible decline in competition from the CLECs in the SME market.

Regarding the Enterprise space, we believe that investors will take it as a positive that the company expressed no interest in pursuing an IXC acquisition strategy. Management noted that it views the Consumer and SME market as the low hanging fruit with which to boost its network utilization. These segments can be grown organically, and are an important precursor to pursuing the Enterprise market in terms of reducing network unit costs to a reasonable level. Management noted that it views the Enterprise customer market as a longer term option.

Wireless 4Major Highlights

Cingular CFO Rick Lindner provided an update on progress at the BellSouth's wireless JV. BellSouth views its Wireless business as a key growth driver and integral to the company's ability to reduce customer churn through bundling opportunities.

As the company recently pointed to softness at Cingular as part of the impetus for the 8/29 guidance revision, mgmt offered additional detail on this front. Regarding the drop in volumes this quarter as a result of the WorldCom bankruptcy, Cingular management detailed that out of 398k WCOM subs at end of 2Q, the company is likely to retain roughly 150k, depending on customer credit quality. However, Cingular stopped recognizing revenue from all WorldCom customers as of the beginning of 2Q, which will impact 3Q revenue growth. Additionally, ARPUs were softer than expected during the first half of the quarter as a larger than expected number of subscribers opted for (and migrated to) the \$29 Cingular Nation calling plan as opposed to higher ARPU products.

Management stated that the \$70M restructuring at Cingular would be complete by mid-November. As part of the restructuring, the company has eliminated 2,500-3,000 positions out of 36k total headcount. The company has converted Cingular sales markets from 30 geographic regions into 13 larger territories with a commensurate reduction in management and sales overhead. Additionally, Cingular has shuttered 50-70 underperforming stores (although simultaneous store openings have left the total store count roughly stable.)

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09/13/2002 10:01

Management noted that the previous capex guidance reduction at Cingular, from \$5.4-\$5.8B to the current \$4.2-\$4.6B reflects (1) reduced capacity building for TDMA, (2) improved vendor/construction pricing, and (3) reduced non-network capex.

Other Highlights from the Trip

Cost Reductions: BLS emphasized that it is successfully stripping significant costs out of the business, keeping the cost structure in line with the growth potential in a weak environment. The BLS cost reduction program, which began in 1Q and should be complete by the beginning of 4Q, will remove 10k jobs, consolidate 60 call centers down to 20, and outsource a number of activities including credit/collections.

Capital Spending: Regarding capital spending, the company relterated its guidance of \$3.7-\$3.9B in '02: Management stated that an increase in the capital budget would arise only in the event of a spike in demand in the Data market, but that a rebound in the economy alone would not impact current expectations. The company provided some limited detail around the composition of its capital budgeting program. Of the total 2002 capex budget, which represents about 17% of revenue expectations, management estimates that about 34% is for targeted new technologies. This is important in that it provides evidence that the significant capex reductions that have taken place over the last year have not come at the expense of future opportunities for growth. This roughly 1/3 of the capex budget is designed to boost the strategic capacity of the network to capture future growth opportunity.

Economy and Pricing: BellSouth estimates that any recovery in operating results is likely to lag an economic recovery by roughly 2 quarters. The company noted that Data pricing continues to hold steady, but notes that as companies emerge from bankruptcy pricing pressure could re-emerge. Pricing in the voice market is not increasing in any environment.

We reiterate our 1-Overweight on shares of BellSouth. While the economy continues to make for a challenging operating environment for all of the telcos, we believe that BellSouth is a solid value in the current market and poised to outperform with any economic upswing. At just 11x earnings and a relative P/E in the low 60% range, BLS shares continue to trade at historic lows off of which they have a consistent record of outperformance. We note that the company is generating significant FCF and providing a 3.4% dividend yield. (Our \$30 price target is based on a combination of sum-of-the-parts and relative multiple analyses, available upon request.)

MegaCap Telecom Services Comps Financial & Stock Performance

SECTOR VIEW: 1-POSITIVE

	STATE OF THE PARTY	Current	Current	Price	FAS 142	Rep. EPS	P	Æ	P/E Rel. 1	o S&P500		% Change	MATHEMA
Company	Ticker	Price	Rating	Target	2002	2003	2002	2003	2002	2003	Week	Month	YTD
T&T Telco - A	T	\$12.32	2-Equal Weight	\$14	N/A	N/A	N/A	N/A	N/A	N/A	6%	24%	-31%
print - A	FON	\$10.03	3-Underweight	\$10	\$1.40	\$1,38	7.2	7.2	0.39	0.42	1%	0%	-49%
west - A.C	Q	\$3.65	2-Equal Weight	\$8 -	(\$0.49)	(\$0.35)	· N/A	N/A	N/A	N/A	13%	224%	-75%
ellSouth - A	BLS	\$23.20	1-Overweight	\$30	\$2.10	\$2.15	11.1	10.8	0.61	0.63	7%	-2%	-38%
BC Com - A	SBC	\$24.50	1-Overweight	\$35	\$2.34	\$2.43	10.5	10.1	0.58	0.59	6%	-7%	-37%
erizon	√Z	\$30.60	1-Overweight	\$40	\$3.09	\$3.14	9.9	9.8	0.55	0.57	6%	6%	-35%
(C Average ⁽²⁾	1						N/A	N/A	N/A	N/A	3%	12%	-40%
BOC Average ⁽³⁾	[. •				1 - 1 - 1	10.5	10.2	0.58	0.60	6%	-1%	-36%
&P 500	SPX	\$883			\$48.50	\$51.50	18.2	17.1	1.00	1.00	1%	0%	-23%

Singhange				NO THE PARTY IN	Enterprise Value, Cashflow & EV Multiples								
	Shares	Market	Net	Non-Con.	Consol.	EBI	TDA	% Gr	A Section of the	EV/EI	BITDA	EV/ A/L	Vieldine Div Yield
Company	Out.	Cap ·	Debt	<u>Assets</u>	EY	2002	2003	2002	2003	2002	2003	2Q02	2002
AT&T Telco(1)	3,649	16.6	17.2	0.0	33.7	9.7	8.7	-25.3%	-9.9%	3,6x	3.9x	na	1.2%
Sprint	892	8.9	5.4	0.0	14.3	4.6	4.7	8.8%	2,3%	3.1x	3.0x	\$1,728	5.0%
Qwest	1,678	6.1	24.8	0.0	30.9	5.4	5.7	-26.9%	5.2%	5.8x	5.5x	\$1,783	0.0%
BellSouth	1,888	43.8	17.0	1.6	59.3	12.7	13.1	-5.8%	3.1%	4.7x	4.5x	\$2,358	3,4%
SBC Com	3,338	81.8	24.3	13.6,	92.5	21.8	22.5	-2.4%	3.2%	4.3x	4.1x	\$1,588	4.4%
Verizon ⁽⁴⁾	2,732	83.6	61.9	11.4	134.1	26.8	27.6	-0.1%	3.3%	4.8x	4.6x	\$2,221	5.0%
IXC Average ⁽²⁾										3.3x	3.4x		3.1%
RBOC Average ⁽³⁾	<u> </u>			·				1 .		4.6x	4.4x	\$2,055	4.3%

value by the number of T shares, added to that the net debt of "Telco" (inc. \$3B in ATTC debt)and arrived at (2) IXC average is the average of T and FON

3) RBOC average is the average of BLS, SBC, and VZ 4) VZ EBITDA excludes 45% of the EBTIDA attibutable to the Vodatone JV.

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Company Description:

BellSouth is an integrated communications services company. BellSouth has 25 million core local customers, and 19 million Cingular wireless customers, and extensive Latin American wireless assets.

Company Name:	Disclosures*	Ticker	Price (9/11)	Rating
BellSouth Corp	A/D	BLS	23.20	1-Overweight
Related Tickers:	Disclosures*	Ticker	Price (9/11)	Rating
WorldCom, Inc	D	WCOM	0.25	0-Not Rated

*PLEASE SEE DISCLOSURE LEGEND ON THE LAST PAGE

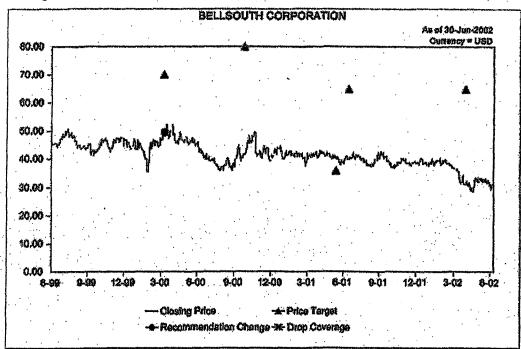
Other Team Members:

R. Dale Lynch 1.202.452.4715 rlynch2@lehman.com
Sean P. Rourke 1.212.526.2125 srourke@lehman.com

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Rating and Price Target Chart: BLS



Date	Closing Price	Rating	Price Target
22-Apr-02	\$31.00		\$65.00
06-Jul-01	\$39.90		\$65.00
07-Jun-01	\$40.51		\$36.00

Date	Closing Price	Rating	Price Target
20-Oct-00	\$41.69		\$80.00
06-Apr-00	\$49.50	1-Buy	
05-Apr-00	\$49.25		\$70.00

FOR EXPLANATION OF RATINGS PLEASE REFER TO THE STOCK RATING KEYS LOCATED AT THE END OF THIS DOCUMENT

Disclosures:

The analysts responsible for preparing this report have received compensation based upon various factors including the Firm's total revenues, a portion of which is generated by investment banking activities.

- Lehman Brothers Inc. and/or an affiliate managed or co-managed within the past 12 months a public offering of securities for this company.
- D Lehman Brothers Inc. and/or an affiliate has received compensation for investment banking services from the subject company within the past 12 months.

Risk Disclosure:

BLS: There are substantial risks to our BLS estimates including (among others) 1) that a timely recovery in the business economy will not materialize, 2) that the price stabilization that we have witnessed within several product groups will not hold, 3) that the sentiment around the telecommunications sector will continue to depress valuation, 4) that our forecasts for revenues and profitability will prove too optimistic.

Key to Investment Opinions:

Stock Rating

1-Overweight - The stock is expected to outperform the unweighted expected total return of the industry sector over a 12-month investment horizon.
2-Equal weight - The stock is expected to perform in line with the unweighted expected total return of the industry sector over a 12-month investment horizon. 3-Underweight - The stock is expected to underperform the unweighted expected total return of the industry sector over a 12-month investment horizon. RS-Rating Suspended - The rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Lehman Brothers is acting in an advisory capacity on a merger or strategic transaction involving the company,

- 1-Positive sector fundamentals/valuations are improving.
 2-Neutral sector fundamentals/valuations are steady, neither improving nor deteriorating.
- 3-Negative sector fundamentals/valuations are deteriorating.

Stock Ratings From February 2001 to August 5, 2002 (sector view did not exist):

This is a guide to expected total return (price performance plus dividend) relative to the total return of the stock's local market over the next 12 months.

- 1-Strong Buy expected to outperform the market by 15 or more percentage points.
- 2-Buy expected to outperform the market by 5-15 percentage points.

 3-Market Perform expected to perform in line with the market, plus or minus 5 percentage points.
- 4-Market Underperform expected to underperform the market by 5-15 percentage points.
- 5-Sell expected to underperform the market by 15 or more percentage points.

Stock Ratings Prior to February 2001 (sector view did not exist):

- 1-Buy expected to outperform the market by 15 or more percentage points.
- 2-Outperform expected to outperform the market by 5-15 percentage points.
- 3-Neutral expected to perform in line with the market, plus or minus 5 percentage points.
- 4-Underperform expected to underperform the market by 5-15 percentage points.
- 5-Sell expected to underperform the market by 15 or more percentage points.
- V-Venture return over multiyear timeframe consistent with venture capital; should only be held in a well diversified portfolio.

Distribution of Ratings:

Lehman Brothers Equity Research has 1435 companies under coverage.

32% have been assigned a 1-Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating, 29% of companies with this rating are investment banking clients of the Firm.

40% have been assigned a 2-Equal weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating, 11% of companies with this rating are investment banking clients of the Firm.

28% have been assigned a 3-Underweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Sell rating, 36% of companies with this rating are investment banking clients of the Firm.

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Robert Fagin 212 272-4321 rfagin@bear.com Mike McCormack, CFA 212 272-4117 mmccormack@bear.com

9/10/02

BEAR, STEARNS & CO. INC. EQUITY RESEARCH

SBC Communications Inc. (SBC 24.88) - Outperform Highlights From Meeting With SBC Management

Key Points

- *** We met with SBC management today in New York. A full discussion follows.
- *** UNE-P remains the most important issue affecting the company. Although competition in the Southwestern Bell territories is stable and predictable, Ameritech and California competitive access line losses will likely deteriorate further. SBC management is actively seeking relief in the form of increased (cost-based) wholesale UNE pricing.
- *** SBC is investing in hopes of organically growing its enterprise market capability. However, management estimates that the company is at least 18 months away from having a meaningful enterprise market product set and five years from gaining traction in the marketplace. AT&T was identified by the company as the acquisition target of choice to speed market entry, but many hurdles exist.
- *** Footprint and spectrum constraints are the major issues facing Cingular. Management believes that consolidation is critical and indicated that a transaction with AT&T Wireless appears to make the most sense. The main obstacles to a transaction are valuation and social/governance issues.
- *** Rated Outperform. Target price: \$32.

								. •		
•		GAAP Estimates			P/E				 —	
•			Q1 Mar	Q2 Jun	Q3 Sep	Q4 Dec	Year	Year		
2001			\$0.51A	\$0.61A	\$0.59A	\$0.64A	\$2,34A	10.6x		
2002			\$0.51A	\$0.61A	\$0.56E	\$0.59E	\$2.26E	11.0x		
2003	٠.						\$2.36E	10.5x	٠.	

^{**}PLEASE REFER TO THE LAST PAGE OF THIS REPORT FOR IMPORTANT DISCLOSURE INFORMATION

Management Meeting Summary

The Company Expects Access Line Losses in California to Accelerate Due to Low UNE Prices and Delayed Long Distance Entry. SBC indicated that competition intensified in California after UNE rates were lowered in May. SBC expects to file a cost docket with the California PUC (CPUC) in hopes of raising UNE rates to what SBC believes is a cost-based rate. Management hopes that the CPUC would rule on the docket by year end. Management believes that competition will stabilize in California in 2003 if SBC receives a positive ruling on the rate case, and as the company gains long distance relief and begins offering a bundled product. The CPUC is now expected to vote on SBC's 271 application on September 19 and SBC would file with the FCC shortly thereafter. This would imply a late December/early January FCC ruling. SBC's current 2002 EPS guidance assumes no benefit from California long distance entry.

Intensifying Competition in the Ameritech Region Will Likely Continue Well Into 2003. Management cited high retail rates and low UNE rates as the key reasons for continued line losses in the region. The company estimates that UNE-P pricing in key Ameritech states is in the \$14-\$15 range, a rate that management contends is far below actual cost. According to management, approximately 70% of SBC's UNE-P growth and access line losses are in the Ameritech region. SBC does not expect to gain entry into key long distance markets in the Ameritech region until mid-2003, further exacerbating the situation.

^{****}Bear Stearns acted as a financial advisor to AOLTime Warner Inc. in its pending transaction with AT&T Corp. & Comcast Corp. involving the restructuring of Time Warner Entertainment.

Competitive Forces May Have Stabilized in the Southwestern Bell Region.

Competitive penetration of the region's local market has flattened in the 15%-20% range. SBC partly attributes the stabilization to its ability to offer long distance service as part of a bundle in all Southwestern Bell states. Also, management cited reasonably-priced UNE rates (in the \$20 range). In contrast to California and the Ameritech region, SBC indicated that consumer revenue in the Southwestern Bell states actually increased 3% last quarter.

Economic Weakness is the Primary Cause of Business Access Line Losses. In contrast, management estimates that 78% of retail consumer access line loss is due to UNE-P with the balance due to the economy (less than 10%) and technology substitution.

SBC's Local Data Business Continues to Grow. Within local data, the high-end of the market is down about 5%, the government and SME markets are up in the double-digits, wholesale data is up 9%, but ISP business is down approximately 44%. Local data trends have not changed much since the end of 2Q02, according to management.

SBC is Pursuing an Organic Strategy to Attack the Enterprise Market ... For Now. Management believes that the company is 18 months away from having a meaningful enterprise product set and five years away from gaining significant market share. Management discussed possible acquisition targets to expedite market entry. Qwest, Broadwing, and WorldCom were deemed less attractive acquisition candidates. Sprint FON was identified as an attractive property but a relatively small customer base was noted. AT&T seemed to be the most attractive candidate to SBC, but the company cited DoJ hurdles in completing any deal. Specifically, SBC believes that it might have to divest AT&T Consumer customers in-region. In addition, AT&T's CLEC business and its small and medium-sized business customers could create problems with DoJ approval. SBC indicated that finding a buyer for those assets would be a challenge. Management believes that over time, margins in the large enterprise market will improve and pricing across most enterprise business products will be stable or increase.

No Anticipation of a Price War in Consumer Long Distance. SBC indicated (and we have observed) that RBOC pricing is in-line or higher than the IXCs'. Management believes that its ARPU and MOU will be relatively stable as the company penetrates markets where it has section 271 relief. SBC assumes that it can achieve 30% market share 12 months after entering a new market and is targeting a long run (3-4 years) penetration rate in the 60%-70% range.

Although Elusive, Wireless Consolidation Remains a Serious Consideration. Management identified spectrum depth and holes in its footprint as the key constraints for Cingular Wireless. The eventual rollout of national wireless data products exacerbate these concerns. SBC also identified duplicative capital investment as a key reason for consolidation. Management identified AT&T Wireless as a potential candidate, but cited valuation, governance, and other social issues as potential hurdles. VoiceStream was also mentioned, but valuation seems to be a stumbling block for now.

Other Notable Information:

excluding WorldCom, bad debt rates have been stable

WorldCom receivable is fully reserved; may see increased levels of bad debt associated with WorldCom due to approximately \$200M of monthly products and services sales; expect cash payments from WorldCom to commence this week excess cash, including any cash associated with BCE's potential purchase of SBC's remaining 16% ownership in BCE (allowable from 10/15/02-11/15/02), will be used to reduce debt pension income erosion will have a significant impact on future earnings

Our Price Target is \$32. We base our objective on a P/E of 13.9x estimated 2002 EPS (a 25% discount to the market multiple). Our target reflects a 6.5x multiple of our estimate of SBC's proportional share of Cingular's 2002 EBITDA (in line with current market value for national wireless service providers), a 6.5x multiple on 2002E directory EBITDA, and a 5.5x EBITDA multiple on the core wireline unit.

Valuation Method For Target Price: Valuation is based on a 25% discount to the S&P 500 P/E multiple.

Q, T, BLS, SBC: Within the past twelve months, Bear, Stearns & Co. Inc. or one of its affiliates was the manager or co-manager of a public offering of securities for this company.

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Bear, Stearns & Co. Equity Research Rating System:

Ratings for Stocks (vs. analyst coverage universe):

Outperform (O) - Stock is projected to outperform analyst's industry coverage universe over the next 12 months

Peer Perform (P) - Stock is projected to perform approximately in line with analyst's industry coverage universe over the next 12 months. Underperform (U) - Stock is projected to underperform analyst's industry coverage universe over the next 12 months. Ratings for Sectors (vs. regional broader market index):

Market Overweight (MO) - Expect the industry to perform better than the primary market index for the region over the next-12 months.

Market Weight (MW) - Expect the industry to perform approximately in line with the primary market index for the region over the next 12 months.

Market Underweight (MU) - Expect the industry to underperform the primary market index for the region over the next 12 months.

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